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General Business Conditions

THE end of the war in Europe was at hand when this Letter was issued one month ago, and the official V-E Day was proclaimed May 8th. The time since has been a period not only for thanksgiving that the long ordeal, the dreadful bloodshed and stupendous waste, is over on one side of the world, but for stock-taking and readjustment to new prospects. In every heart are feelings of pride in the armed forces, of reverence for the dead and gratitude to the living. Mingled with these are thoughts of the immensity of the war in the Pacific and of the sobering responsibility to support the struggle to the end. Another feeling is that of pride in the achievement of the people at home, in industry, on the farms, and in transportation and other services.

Despite inevitable mistakes and lack of understanding and co-operation by individuals, the country has organized and developed its war powers in a way which commands the admiration of the world. The visible signs are the power and effectiveness of the army and the might of the navy and air force, all created and backed by a production record that is unparalleled in history. The goals at the beginning staggered the imagination, but the achievement has exceeded the goals.

The war in the Pacific will make great demands both upon the armed forces and upon productive facilities, but it is safe to say that they will be met abundantly and with single-minded devotion. At the same time resources are becoming available to rebuild the civilian economy. With cutbacks in war production already in effect and more to come, business men are acutely conscious of reconversion problems. It is also safe to say that these problems too can be solved and the difficulties rapidly overcome, provided the initiative and resourcefulness displayed in the war effort are allowed to work unhampered for that purpose.

The industries have to their credit a miracle of conversion. What is needed in the months to come is an equivalent miracle of reconversion. It is needed to speed the flow of goods into the markets, to provide employment, to supply civilian requirements and restore living standards, and thereby to combat the menace of inflation and cure the evil of black markets. In important respects it should be easier to reconvert than it was to convert, since the industries will be returning to the manufacture of familiar goods. The question is whether they will be hampered or helped. They will require no prodding, but they will need a clear road as soon as possible and freedom to go ahead.

Mr. Krug's Report

From this viewpoint, the most important development since V-E Day has been the revelation of the policies of the War Production Board, as shown both by its acts and in the comprehensive report of Chairman Krug released to the press May 28th. This report is a document which business men should read with great satisfaction. It establishes the principles which will govern the decisions of the W.P.B. during the reconversion period, and tells business men what to expect. It may be appropriate here to repeat a statement made in this Letter in April 1944, when reconversion policies were under discussion:

> **. . . In historical perspective the reconversion period will not be long but its importance will be great, for in it a turn may be made either toward, or away from, the perpetuation and extension of detailed government controls over business. The decisions made will not only affect the volume of business activity and employment; they will also exert a lasting and profound influence upon the nature of our economic system in years to come.**

In this perspective Mr. Krug's statement of principles stands out as a document of historical importance. It affirms faith in free enterprise. It rejects the idea that government planning, in the sense of control by blueprint, can be as effective or lead to as desirable ends as private planning. Like the Baruch-Hancock report and the third annual report of the Special Senate Committee headed by Senator, now President, Truman, both

published early in 1944, it takes its stand on the simple ground that government regulation, administration and control would impede and slow up the reconversion process and diminish production and employment. The keynote is the declaration that "it is necessary to get rid of regulations and production limitations as quickly as possible. They automatically put ceilings on initiative, imagination and resourcefulness, the very qualities the country will need most if we are to have a resilient and rapidly expanding economy after the defeat of Japan."

This declaration is being put into practical effect by removing prohibitions and limitations on the manufacture of specified civilian goods. Mr. Krug noted that 156 W.P.B. orders and schedules had been revoked, out of 650 which were in effect April 1st this year. He said an additional 83 will be revoked in the next six weeks and more as the materials situation is eased by further cutbacks. The orders revoked cover an immense number and variety of civilian products. Limited production of automobiles has been authorized as soon after July 1 as manufacturers can get going, and it is expected that some 200,000 cars may be produced toward the end of this year. Similar limited programs for electric refrigerators and washing machines are in the making. Limits on construction work have been raised to higher figures. Those on farm machinery have been removed. Production of more civilian trucks and railroad equipment has been authorized.

To "Scramble" for Materials

Manufacturers thus freed for civilian production will have to "scramble" for materials, except as they come under "war-supporting programs". Mr. Krug states emphatically that "direct military and war-supporting programs will have first claim on materials, and expansion of civilian production will use only residual quantities not required for essential war needs." How abundant these materials will be in the months immediately ahead—and hence how rapidly production of these civilian goods may be resumed or increased—is still to be seen. Mr. Krug stated that war production scheduled for the remainder of the year is less than 10 per cent below the pre-V-E Day rate. If this projection holds, releases of many critical materials will be on the small side for some time, and the fact that shortages of lumber, textiles, tin, leather, natural rubber, and certain chemicals and other products will continue is well known.

On the other hand, cutbacks in munitions schedules are felt early and with multiplied effect in materials markets, while manufacture of finished goods is carried on out of inventory. New orders for steel, copper and many other materials have declined sharply and cancellations of old orders have increased. The trend is plainly toward mounting supplies, and it will be accelerated if, as many believe, cutbacks turn out to be greater than Mr. Krug anticipates.

In any case the circumstances called for a determination of policy to govern as supplies increase, and the policy is that priorities will be limited to "direct military and war-supporting programs." "Residual quantities" will move freely into unrestricted use, without government allocation. Mr. Krug said:

> In this way, the choice of what and how to produce, buy and sell, after positive assistance to the military and essential war-supplying activities, will be left to the decisions of the thousands of manufacturers, wholesalers, retailers, farmers and ultimate consumers rather than to government agencies and officials . . .
>
> The danger confronting us, as I see it, is that we will overlook the natural resilience of the economy—the capacity of manufacturers, wholesalers and retailers to readapt themselves to changed conditions and hence quickly to utilize the resources released from munitions production. If we were to attempt in Washington to see that every manufacturer, wholesaler or retailer got his exact share of released manpower or materials, we should be lost in a myriad of rules and regulations. We should get in the way of reconversion rather than speed it.

Mr. Krug referred to the difficulties of the War Production Board in administering controls even under one "clear-cut, unequivocal" criterion, namely, "wherever the particular use of a material or a facility would best contribute to the prosecution of the war." Then he asked, how much greater would be the administrative task if — when this criterion is no longer applicable — the Government were to undertake to determine whether materials and facilities should be used in one industry rather than in another, or in one community rather than in another, or by one competitor rather than another? How should newcomers be treated? Would a particular decision contribute to greater employment, or to greater price stabilization, than some other decision? He also referred to the elimination of paper work as a boon to business.

A statement in the third report of the Truman Committee is applicable here. It said that to attempt detailed regulation would impose an intolerable burden not only upon the administrative agency, but also "upon the manufacturers, particularly the small and intermediate ones, for each manufacturer would have to come to Washington with hat in hand."

Administrative complexities and burdens are not merely onerous. In this instance their most important effect, from which everyone would suffer, would be the mistakes and injustices inevitable in administrative decisions, the delays, and the interference with production and employment.

Arguments for "Making Work"

One other section of Mr. Krug's report deserves special attention and we quote it in detail.

> . . . As the cutbacks increase, some areas are bound to experience unemployment. In that event, local chambers of commerce, union leaders and business men may urge the Government to take special measures, such as providing a public works program, or putting in war contracts to tide over the slump, or making special releases of materials for civilian production.
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> In many areas, time will solve such dislocations—as peacetime industries start up and hire workers; but in some areas, special measures taken to maintain employment would merely postpone the eventual day of reckoning — as for instance a war-boom town which is greatly expanded because of a particular war plant with little or no postwar future. We must prepare to meet such emergencies when they are real; but we must also be prepared to resist the pressure when they would only delay necessary readjustments.

We venture to add to this statement an opinion that the pressures to which Mr. Krug refers will not come wholly from outside the Government, but also from elements within it, who believe that public works programs or other government spending are desirable whenever and wherever people are out of jobs and who constantly urge the adoption of a legislative policy to that effect.

From whatever source, proposals such as those described are objectionable in two respects. First, they would require wasteful expenditure which would add to the cost of government and to the inflation menace. Hence they are inappropriate to the present time, when the need is to reduce spending. In the second place, as Mr. Krug says, they would delay necessary readjustments. They also overlook the fact that prudent people have accumulated reserves of savings in unprecedented amounts to carry them through a transition period; and that workers are entitled to unemployment compensation for periods running as high as 26 weeks. The states hold reserves in excess of $6 billion accumulated for this purpose, and the first impact of unemployment should be borne by these reserves. Veterans receive demobilization pay running up to $300 and in addition are entitled to further compensation of $20 a week up to 52 weeks if unemployed during the first two years after their discharge or the end of the war.

As between efforts to shelter people from inescapable readjustments, and policies relying upon government economy and individual enterprise to establish a sound general prosperity, the advantage is all with the latter. Special measures for the benefit of some people or communities are at the expense of others, while policies designed for the general benefit help all go forward together.

Answers to Dissenters

Past discussion of reconversion policies indicates that there will be some dissenters from Mr. Krug's program. Some believe as a matter of doctrine that "planned reconversion" and continued government control would yield better results than the way Mr. Krug points out. Others, even though considering themselves sincere believers in private enterprise, nevertheless appear to lack understanding of, or to shrink from, the obligations which go with belief in private enterprise.

The argument is sometimes heard that free reconversion and a scramble for materials may produce inequities, and that an "equal start" for all competitors should be guaranteed by Washington, or that newcomers should be forbidden to enter the industries until the situation again is normal. With respect to these arguments, the War Mobilization and Reconversion Act of 1944, passed last August, specifically provides that non-war production shall be permitted whenever it does not interfere with production for war purposes, regardless of whether some competitors are free from war production before others and regardless of the previous position of producers in the industry. This provision reflects the considered opinion of the Congress. The fact is that an "equal start" would usually mean that somebody would be held up; carried to its logical end, everyone would be held up until the war was over and war contracts no longer needed. In any case the red tape, the burden of the detailed decisions required and the work put upon both the administrative agency and business would cause intolerable delay, friction and difficulty. As for the fear of inequity, the Truman report answered that by pointing to the greater inequities produced by government regulation.

It is true that the automobile, refrigerator and washing machine programs, which limit production by establishing quotas for individual companies, appear to emphasize the equal start. The argument in these cases is that the needs of these industries for materials, and their buying power, are so great in proportion to the quantities soon to become available that the markets would be disorganized and possibly the war effort impeded if they were free to convert without limit. For this reason the exceptions are made. Since the choice at this time is either a limited number of these things or none at all, there is no occasion to criticize. The important matter is that the exceptions should be as few as possible and the quotas abandoned as early as possible.

The Question of Priorities

Still another form of criticism may come from manufacturers who will feel that their

product is more essential than some other product, and will therefore argue that W.P.B. should give them priority in obtaining scarce materials. They would hope to avoid the "scramble". Of course people need some things more than they do others if the economy is to function efficiently. Food is the basic need of life and never was there greater need of farm equipment to help increase food production. In the complex modern economic society mass transportation to move materials and finished goods and to carry people to and from their work is a basic need, and transportation facilities are strained almost to the breaking point. Allocations of material for farm machinery, railroads and motor trucks and buses are not arbitrary but are soundly grounded on natural requirements. They are not only "war-supporting", but vital in restoring the civilian economy, making up shortages and combatting inflation.

Nevertheless, the list of truly basic essentials is a small one, and for reasons both of administration and of fairness to all concerned it must be kept small. Who would say whether consumers are entitled, for example, to one item of household equipment above another? If preference is shown the door will be open to all kinds of pressures, priority for one would mean less for others, and the end-result would probably be complete allocations.

The opposite policy of requiring manufacturers to rely upon their ingenuity and resourcefulness is the policy under which the private enterprise system has flourished. Those who would substitute government allocations should give heed to the broader implications, and ask themselves when, if at all, they will get rid of government controls if they continuously ask government help.

New Attitudes Needed

For a good many people, both in government positions and in business, a proper understanding of reconversion problems will require a change in attitudes and habits of thought. Officials who have been granted power to direct and control sections of the economy have become accustomed to the power, and naturally think of both it and themselves as indispensable. Some business men have learned to lean on the overhead authority and now dread its dissolution.

Such attitudes are barriers to speedy reconversion and to reestablishment of healthy, growing business. Mr. Krug has set forth his position clearly. There are now two questions, What will be the attitude of other government agencies? Will business on its side show an equal readiness to dispense with government help?

The renewal of the Price Control Act is now under debate. The general view is that termination of price controls on June 30 when the Act expires would be premature, and renewal is expected. However, the Office of Price Administration has the same responsibility to see that price controls do not hamper reconversion that W.P.B. has with respect to production controls. If the O.P.A. limits prices to a point where there is no profit in making certain items, it will discourage the production of those items. Some of its pricing measures have had that effect in the past, in foods and textiles particularly, and are having it now. In justification of pricing policy it is frequently argued that the profits of an industry as a whole or of the single company involved are satisfactory, but overall profits are not the practical test. The real question is whether production of needed products is restricted and discouraged, and whether relief is obtainable without interminable delays and prohibitive red tape. On the other side of the question, business for its part will have the responsibility of not seeking exorbitant profits, but rather of setting prices at levels which will achieve the maximum production and distribution of goods.

Workers in war plants likewise will face new conditions in months ahead. They have had employment in war work at war wage rates and have taken home abnormal overtime pay. But shipyard workers moving into textile plants, for example, will not be able to obtain shipyard wages because the textile industry could not long sell its products if they were priced on that basis. The governing factor is what consumers can pay. A readjustment to peacetime conditions is inevitable. Workers want increases in hourly rates sufficient to offset elimination of overtime, but the danger is that higher rates, increasing production costs, will price products out of the market and diminish industrial activity. It is in the interest of workers themselves and of the whole country that the adjustments should be on a basis which will produce maximum employment.

The Seventh War Loan

As we go to press, the country is embarked upon the seventh of its series of great war loans. Though the overall goal of the loan, $14 billion, is the same as that of the 6th War Loan and much below the aggregate of $21.6 billion actually raised in that loan, it presents in some respects a still greater challenge than did earlier drives. In the first place, the quota for individual subscriptions has been raised from $5 to $7 billion; secondly, there is a need for extra effort to offset any possible psychological let-down following the victory in Europe; and thirdly, the Treasury, by the terms and conditions of its offerings, has gone further even than in previous drives to confine the

buying to real investors and to keep down the use of commercial bank credit, with its inflationary effect upon bank deposits and purchasing power.

As our readers are generally aware, commercial banks since the 2nd War Loan have been excluded from direct subscription to war loan offerings, except for limited amounts for investment of savings deposits. They continued to participate indirectly to an important extent, both through their loans to other investors to finance subscriptions and their purchases of outstanding Treasury and other securities from investors who were disposing of them in order to subscribe to the new issues. Operations of this kind have been considered legitimate and not subject to criticism where (a) the loans were to genuine investors who would pay for them out of savings within a reasonable period, and (b) where the banks did not solicit sales of outstanding government securities by customers for the privilege of entering subscriptions and thereby obtaining war loan deposit credit.

The problem has been to cut down the use of credit by speculators subscribing to government securities for a "quick turn," and to discourage excessive switching from old to new issues — either for the purpose of sales credit to the subscriber or war loan deposit credit to the banks. In the sixth loan, the expansion of bank credit, represented by bank loans against securities and by purchases by the banks of outstanding securities from other investors, together amounted to over $10 billion or approximately 50 per cent of the total amount of new money raised.

In order to check these practices so far as possible and confine the loan more closely to genuine investment money, the Treasury reiterated its earlier request that the banks decline to finance speculative subscriptions to government securities, and that other investors refrain from selling securities solely for the purpose of subscribing to new issues. Offsetting the rise in the individual quota to $7 billion, the corporate and institutional quota, in which excessive turnover had been most pronounced in the past drive, was lowered from $9 billion to $7 billion. Also, since the new 5½ year 1½ per cent bond will not be available to corporate and institutional subscribers, there will be no comparable replacement for such investors who otherwise might switch out of medium-term securities purchased during previous drives. There will be no open-market issues for corporate and institutional investors between the 1 year ⅞ per cent certificates and the 14-17 year 2¼ per cent bonds.

The drive for savings bonds and tax notes opened on April 9, and for all marketable issues to individuals on May 14. Sales to individuals, particularly of Series E bonds and the 22-27 year 2½s, have been encouraging and have continued strong since V-E Day, indicating that the expanded goal for individuals should be realized by the end of the drive. The drive for corporate and institutional subscriptions, embracing only the ⅞ per cent certificates and 2¼ and 2½ per cent bonds, will be open only between June 18 and June 30, although all marketable issues will be dated June 1, with interest accruing from that date.

Price Changes in Outstanding Government Issues

Announcement early in March of the types of issues to be offered in the 7th War Loan was followed by further strengthening in the market for all medium- and long-term Treasury bonds available for purchase by commercial banks. The request made to corporate and institutional investors not to make switches in government securities in connection with the war loan except for ordinary portfolio adjustments, and the limiting of subscriptions to the new 1½ per cent bonds to individuals (except for restricted amounts against savings deposits in commercial banks), brought renewed buying into the market, due to the scarcity that will exist of the new 1½s when issued and to the desire of the commercial banks to find investments in the 5-10 year group of maturities. The 8-10 year 2s offered in the 6th War Loan sold up to a premium of over 3 points, reducing the yield to a little over 1½ per cent. Accompanying these changes, demand spilled over in larger volume to the 2½s of 1967-72 — the only long-term fully taxable issue presently eligible for commercial bank purchase — carrying this bond to a new high of 104 to yield 2.27 per cent.

In contrast with this behavior in the bank eligible list, the 2½ per cent issues ineligible for bank investment (until 10 years after issue dates), after rising sharply early in the year on fears that the Treasury might lower the coupon rate on the long-term component of the 7th War Loan, reacted from the peak following disclosure that new 2½s would again be offered. At the close of May, the bank ineligible 2½s of 1966-71 were selling to yield 2.43 per cent, as against the 2.27 per cent yield on bank eligible 2½s of approximately the same maturity, and in the face of a new ineligible issue of 2½s at par. The difference in yields on the two outstanding issues reflects the high premium being paid for current bank eligibility; while the fact that non-bank investors are willing to purchase the outstanding long-term 2½s that yield 2.43 per cent, when they could subscribe to new 2½s at par, is due at least in part to the older bond

becoming eligible for bank investment several years before the new.

With the development of these spreads between prices of governments that commercial banks are permitted to buy now and those which they may buy only after an extended period, there have really come into being three separate and distinct markets for Treasury bonds — those issued prior to March 1, 1941 which are partially exempt from federal taxes, and the two groups of fully taxable securities issued since that date. The broad trends in these separate markets over the past year are shown by the following table giving representative issues in each group.

Yields to Maturity or Nearest Call Date of Representative U. S. Government Bonds of Over Six Years Maturity

Partially tax exempt and eligible for bank investment	June 30, 1944	Dec. 30, 1944	May 29, 1945
2½s of 12/15/49-53	1.16	1.05	0.91
2¾s of 6/15/51-54	1.31	1.23	1.07
2⅞s of 3/15/55-60	1.61	1.52	1.38
2¾s of 12/15/60-65	1.89	1.84	1.68
Fully taxable and eligible for bank investment:			
2s of 3/15/50-52	1.76	1.70	1.39
2s of 9/15/51-53	1.93	1.88	1.52
2s of 12/15/52-54	*	1.95	1.59
2½s of 9/15/67-72	2.47	2.46	2.27
Fully taxable but not now eligible for bank investment:			
2¼s of 9/15/56-59	2.23	2.18	1.90
2½s of 6/15/62-67	2.46	2.44	2.31
2½s of 12/15/64-69	2.49	2.47	2.41
2½s of 3/15/66-71	*	2.47	2.43

*Issued since June 30, 1944.

A broad underlying influence working through all three groups has been the growing confidence on the part of investors that the pattern and generally low level of interest rates will be maintained, and hence that it is just as safe to buy the long bonds as it is to buy the short. The policy of the Treasury and the Federal Reserve Banks in holding down the short rates has further encouraged buyers to reach out to an increasing extent to the long-term, higher yielding issues, with the inevitable effect of depressing the yields in these groups. This tendency naturally has been accentuated by the present Treasury policy of restricting the volume of new securities offered in the intermediate maturity range.

While the Treasury has continued to supply the market with long-term 2½s, nevertheless the decline in yields of those outstanding Treasury securities which commercial banks can buy tends to pull down the general level of interest rates. Should this occur it would mean cutting still further the return to insurance companies, savings banks and other long-term investors — already at its historic low.

This continued forcing down of intermediate and long-term interest rates could be checked by the Treasury allowing the short-term rate to advance, thus attracting bank buying to the nearer maturities, or by following the war loan drives with special offerings to commercial banks of the intermediate maturities suited to their portfolio.

Federal Tax Plans

With the defeat of Germany, the problem of what to do about postwar taxes calls for definite decisions and action. As industry begins in a limited way the process of reconversion, the tax system should move as rapidly as possible in a similar direction so as to prevent the extremely high wartime rates from unnecessarily restricting business activity and employment.

In mapping any program of tax relief it is recognized that in taxes, as in production and trade, the considerations of the expanding scale of war in the Pacific must come first. The Treasury must continue to finance a tremendous total of war expenditures, including the costs of occupation in Europe, of transporting the armed forces and war equipment and supplies to the Far East, of demobilizing some two million veterans, and of settling large numbers of contracts to be terminated. Even with a substantial reduction in the total of government expenditures, there would still be a heavy deficit on the basis of current tax yields.

Thus, two principal questions arise: first, what steps towards tax relief can be taken now that will be consistent with the war effort; and, second, what general reduction of tax rates should be put into effect as soon as the military situation permits. Both questions are urgent.

Fortunately, in our approach to these problems, we are not now starting from scratch. For more than a year both the Treasury and the Congressional Joint Committee on Internal Revenue Taxation have been studying these questions, and a number of private groups, including the Tax Foundation, National Planning Association, Committee for Economic Development, and Twin Cities Research Bureau, have made notable contributions. This has provided a background of research and careful thought which should be helpful not only in working out the right program, but in putting it into effect more promptly.

Proposals for Immediate Relief

As a first major step in the program of readjusting the tax system towards postwar, the Congressional Joint Committee announced last month a series of recommendations for

immediate legislative action designed to facilitate reconversion by improving the cash position of business enterprises, and giving special assistance to small corporations. The changes proposed, which apply only to the corporations and do not affect individual taxpayers, would not mean for the most part any net reduction in ultimate tax liabilities, but would advance the dates of various tax refunds and credits to which corporate taxpayers are entitled but which under present law would become available only over a longer period. The proposals were worked out jointly with the Treasury. They have been approved by President Truman, by Chairman George of the Senate Finance Committee and Chairman Doughton of the House Ways and Means Committee, and have been well received by the public generally.

In brief, the five-point program embraces the following:

(1) Make the postwar credit of 10 per cent of the excess profits tax currently available for tax liabilities of 1944 and subsequent years.

Under the present law, the 95 per cent excess profits tax must be paid each year in full, subject to a 10 per cent refund at stated years after the war. Under the proposed formula, the credit could be taken immediately, thus having the effect of reducing the net cash outlay for excess profits taxes by this amount.

(2) Advance to January 1, 1946 the maturity date of outstanding postwar refund bonds.

This proposal follows logically from Proposal (1) above and would advance the date of payment of the 10 per cent refund on excess profits taxes paid in 1942 and 1943, now represented by special noninterest-bearing bonds issued by the Treasury and payable at intervals of two and three years after the war.

(3) Speed up refunds resulting from the "carryback" of net operating losses and of unused excess profits tax credits.

Under existing law, business concerns which experience a sharp drop in earnings resulting either in a net operating loss or a level of earnings below that subject to excess profits taxes are permitted under a provision known as the "carryback" to offset such loss or deficiency of earnings against the net income subject to taxes in the two preceding years, thus entitling them to recompute taxes and file a claim for refund. At present, however, such claims cannot be filed until after the close of the year, and normally take a protracted period before they can be audited and approved by the Bureau of Internal Revenue.

Under the new proposal, corporate taxpayers which anticipate a drop in current income would be permitted, on the basis of their own estimate, to take immediate credit for the "carryback" and to make a deduction from the current instalments due on the preceding year's taxes. As a protection to the Treasury, such action would be subject to a later audit by the Revenue Bureau, to an interest charge of 3 per cent to discourage unnecessary use, and, in the event of overestimating the credit, to a penalty payment of 6 per cent. Furthermore, the Commissioner of Internal Revenue would be empowered to disallow immediately any such claims which in his judgment were clearly excessive.

(4) Speed up refunds resulting from the accelerated amortization of emergency plant facilities.

Companies which have invested in emergency plant and equipment for war production are now allowed to amortize, or charge off, for tax purposes the cost of such facilities over a period of five years, or over a shorter period if the war ends or the facilities are certified as no longer needed for national defense. In the latter event the taxpayer may recompute the amortization deductions on the basis of the shorter period, which will result in larger deductions for preceding years and give rise to claims for tax refunds. Since the handling of these claims through the usual administrative procedure involves considerable delay, it is proposed to pay such refunds within 90 days, subject to subsequent audit and adjustment.

(5) Increase the specific exemption under the excess profits tax from $10,000 to $25,000, effective for 1946.

This alone among the five proposals would reduce ultimate tax liabilities. Under the original excess profits tax law of 1940, the first $5,000 of net income of all corporations, regardless of size, was exempted from excess profits tax, and for 1944 this exemption was raised to $10,000. The number of corporations subject to excess profits taxes was, according to the Joint Committee report, approximately 68,000 for the taxable year 1943, while under the larger exemption it was reduced to an estimated 51,000 for 1944, and — apparently reflecting an expected decline in corporate income — is estimated at 31,000 for 1946. Raising the exemption to $25,000, as now proposed, would reduce the number paying excess profits taxes for next year to an estimated 19,000, out of a total of some 469,000 active corporations. This step would especially aid the large number of small corporations, many of which have experienced difficulty in building up adequate liquid resources for reconversion in the face of the high excess profits taxes.

While the proposed increase in excess profits tax exemption would provide important benefits to large numbers of small concerns, the great body of corporate income, produced mainly by the larger corporations, would be

relatively little affected. It is estimated that the increased exemption would reduce excess profits tax liabilities by only $300 million; and since the income thus released from excess profits taxes would then become subject to the corporate normal and surtaxes, the net reduction in taxes would be only $160 million. This is less than 2 per cent of the total revenue receipts from corporate income and excess profits taxes.

Proposals (1) to (4), although not reducing ultimate tax liabilities, have been estimated roughly at making $5.5 billion available to business currently or in the near future, when it is likely to be most needed, instead of some years after the end of the war. This cash will mean a lot more to business in the period when concerns are under heavy expense in changing over to peace-time operations and reestablishing their lines than it will later when these readjustments have been completed.

The Longer Range Problem

While there has been general agreement as to the five-point program for immediate action, there has been more difference of opinion expressed as to how much further we should go in providing tax relief before the final termination of the war with Japan. President Truman, Secretary Morgenthau, and Judge Vinson, director of War Mobilization, have taken the position that no general tax reductions should be made until Japan is completely beaten, and Chairman Doughton of the House Ways and Means Committee seems to hold a similar view. Chairman George of the Senate Finance Committee, on the other hand, has been quoted as saying that in his opinion, "Tax reduction, both as to business and individuals, particularly individuals, must be effective on 1946 incomes, regardless of the status of war with Japan." Such reductions, he asserted, are necessary "if we are to preserve the American economy" and avoid the danger of "an economic nose-dive when Japan surrenders."

Senator George, who is chairman also of the Senate Postwar Planning Committee, is undoubtedly right in stressing the importance of getting tax reduction started at the earliest possible date. It will be impossible to reconvert American industry and get a healthy and vigorous recovery of the enterprise system under the high wartime tax rates, with their discouragement to efficiency and economy in corporate management and their repressive effects upon corporate and individual investment.

On the other hand, so long as war expenditures and the budget deficit continue anywhere near the present high levels, there will be need for all the taxes we can collect, in order to minimize the inflationary effects of government spending and to hold down the growth of the public debt with its mounting burden of interest costs. We want to preserve the integrity of the American dollar, and, as the President said, protect the 85 million individual holders of war bonds; and this means collecting adequate taxes. Moreover, while government expenditures and national income are around peak levels, it is relatively easy for the Treasury to collect huge tax revenues, and business needs no tax reduction as a general stimulant.

These apparently differing viewpoints may perhaps be resolved by the circumstances themselves, and the stand we take on them depends on several variables — when the war ends and the rate of expenditures as the war goes forward, as well as the rate of tax receipts. Should expenditures taper off markedly before the final V-J day, resulting in widespread curtailment of war production and development of serious unemployment, a policy of lowering tax rates would afford relief and aid in effecting the readjustment, and might actually increase rather than reduce Treasury revenues. It should be possible to have a tax bill drafted and ready, but leave the matter of effective date to be determined finally by the progress of events. In this way we would be prepared to act and business would be helped by knowing what it could count upon.

In looking forward to what this program should be, certain facts seem self-evident:

(1) The corporate excess profits tax has no rightful permanent place in a private enterprise economy. Apart from any question as to the merits or demerits of this particular excess profits tax law, such a tax, while appropriate in time of war, when revenue needs are at maximum and business earnings are largely the product of the Government's enormous spending, is in peacetime completely inconsistent with a free competitive system. This system derives its driving force from the principle of adequate return for initiative, resourcefulness, and the successful taking of risks. The excess profits tax works in precisely the opposite direction. It penalizes rather than rewards success by laying a special tax upon concerns which by virtue of good management or other factors are out ahead of the crowd. It discourages efficiency and efforts to control costs, and hits especially the new and rapidly growing concerns and industries.

The proposed raising from $10,000 to $25,000 of the net income exempt from excess profit taxes is a recognition, insofar as small business is concerned, of the effect of this tax in retarding the building up of corporate finan-

cial strength and in stunting growth generally. The proposal is good so far as it goes; but it would be unfortunate if people accept this as adequate and lose interest in the need for eliminating this tax on the "big fellow" as well as the "little" at the earliest possible date in the transition period. After all, a tremendous amount of employment and leadership in industrial development depends on these "big fellows." Complete repeal of the excess profits tax would not involve anything like a corresponding shrinkage in Treasury revenue, since the net income released from this tax would become subject to the corporate normal and surtax, together amounting to 40 per cent at present.

(2) The high wartime personal income tax rates are equally incompatible with the peacetime private enterprise economy. It is one thing to expect people to bear such taxes in war when patriotism is a big factor, and another thing to expect it in peace. Not only have these heavy taxes been particularly tough for many small taxpayers whose incomes before tax have shown little or no increase, but they are a discouragement to incentive at all income levels. With the small taxpayer it is a question of being able to enjoy a few more of the good things of life for himself and his family, to build a backlog of savings against emergencies, or to accumulate a stake for starting a small business. With the large taxpayer it is a question of reward for extra effort, and of adequate opportunity and inducement for reaching out with capital and know-how to start new enterprises and to help others to grow.

While the principle of "progression," or graduation, in the personal income tax has been generally accepted as equitable in accordance with the doctrine of "capacity to pay," the carrying of such progression to the point where two-thirds to three-quarters and more of total income is taken in taxes represents such an extreme application of the progressive tax principle as to raise the question why those capable of earning these incomes should continue devoting their talents and energies to constructive enterprise instead of sitting back and taking it easy. Though the burden of tax on the upper bracket incomes may not evoke much sympathy among the masses of the people, its economic effect is nevertheless not to be ignored. It is in these high bracket incomes that experienced management is found, and where the money comes from that starts new ventures. A larger amount of tax leeway there will do more than all the new mechanisms being proposed to supply needed capital for small business. The way to get venture capital is to release it, and encourage it to go to work in the manner that has built up this country.

A scaling down all along the line on these excessively high personal income taxes is clearly an essential part of any program for helping business during the transition period and afterward. At the same time there is worth keeping in mind one achievement of our wartime tax policy that is of permanent advantage in a democracy — the wide percentage of the people paying direct taxes and hence made more conscious of the cost of government. So long as people feel they are just "soaking the rich" it is harder to keep expenditures under control. Support for economy is likely to be easier when taxes and votes have some relation to each other.

The Congress, in formulating tax legislation, will undoubtedly seek the advice of business and other groups which have been studying these questions. While there is considerable agreement on various phases of tax policy, there are also divergent views on some important points. It would be helpful if these groups could get together and iron out as many as possible of these differences, and thus present to the Congress a set of proposals which all could get behind and support.

Control of Spending the Key to Tax Relief

In all talk of tax relief, it must of course be borne in mind that the extent of any reduction in tax rates is going to depend upon how far we are willing to go in reducing government spending after the war. From the number of proposals constantly brought forward that would involve drafts on the Federal Treasury, it is cause for wonder where their sponsors think the money is coming from and how they reconcile their proposals with the idea of lower taxes everywhere agreed to be necessary in the postwar period.

A difficulty is that proponents of individual spending projects, many of which undoubtedly have merit, either do not stop to calculate what the sum total of demands is mounting up to, or they are impelled by political motives to go ahead and "try to get theirs while the getting is good." Undoubtedly, too, an influence in the background has been the spread of the philosophy in recent years that economy in government is an old fashioned notion, and that we need not worry about how much the government spends or how much debt it accumulates, since the spending distributes "purchasing power" and the debt is "all in the family."

One of the most insidious arguments being advanced nowadays to promote spending projects is that the cost of a particular undertaking amounts to only such and such per cent of what the Government is spending currently

for war. Such reasoning could hardly be more fallacious, and is tantamount to saying that an individual who has been spending far beyond his means need not bother about additional extravagances so long as they are less than those in which he has been accustomed to indulge. The very fact that we *have been* spending and piling up debt at such a terrific rate is argument *not* for continuing to spend, but rather for *scrutinizing expenditure projects with extra care* and practicing the utmost frugality.

Unless there is a deeper consciousness generally of the need for a drastic pruning down of unnecessary government costs in the postwar period, hopes for any substantial measure of tax relief are likely to prove illusory. Nor is the present any too soon to begin retrenchment. It is gratifying that the President has moved promptly in recommending reductions in proposed expenditures for the fiscal year 1946 made possible by changing war conditions, while the House Appropriations Committee has shown a disposition to seek additional savings in various government departments and agencies. This search for economies should be pressed with all possible vigor. While expenditures vital to the prosecution of the war must of course go on, there is plenty of room for trimming millions of dollars of unneeded outlays from the budget by tightening the vast organization of government (as the President has asked power to do), eliminating the many duplicating and overlapping functions, and suppressing an unconscionable amount of nonessential spending masquerading as necessary in the war effort.

Most important of all, the American people need to get out of the habit of trying to solve every economic problem by running to government for some kind of subsidy or financial guarantee, the sum totals of which easily run up to staggering amounts. The practice of leaning on government handouts where people should be working out their problems themselves is not only perilous to the country financially, but even more so morally in its effect upon the industry, initiative, and self-reliance of its citizenry. Business would do well to watch its step to see that it does not set bad precedents in this respect. The policy of the American Bankers Association in opposing federal guarantee of bank loans after the war is a notable example of awareness of the danger of making a crutch out of government.

Senator George sized up the situation in a few words when he said recently, "I am more and more impressed that we have got to use more judgment in spending money, as well as a lot more judgment in levying taxes, if we are to have a sound fiscal system and a sound economy."

Europe's Food Problem

Europe's most pressing problem from now until her 1946 crops are harvested is to obtain and distribute equitably enough basic foodstuffs to furnish everyone at least the minimum necessary to maintain health. This means, first, immediate relief of those urban populations in most need; second, restoration of orderly distribution; and, third, rehabilitation of Europe's own agricultural production. Because of the general disorganization and shortage of labor at the time when the bulk of crops were to be planted, the coming harvest will probably be the smallest since the war began if not the smallest since just after the First World War. Yet food is the first necessity.

Under normal circumstances the overall food deficit of the Continent was small. It is estimated by the Food Research Institute of Stanford University that Continental Europe outside Russia was normally dependent on imports from overseas to the extent of only about 7 per cent. Aside from Finland and Greece, the countries lying east of Germany, Austria and the Adriatic Sea supplied their own needs and most were able to export surpluses to the Western countries. Even the latter collectively raised the greater part of their food.

This high degree of self-sufficiency, however, was based on a highly integrated system of interchange developed over a long period. The 245 million rural Europeans virtually fed themselves and, in addition, provided most of the food required by the 105 million urban inhabitants, in return for manufactures and services, the interchange taking place both within each country and across borders. Eastern Germany and the Danubian basin shipped grain, livestock and animal products. Czechoslovakia and Poland shipped sugar, and the Mediterranean littoral fruits and olive oil. The trade in potatoes was largely internal, as was also the trade in rye and feed grains other than corn. About one-fourth of the wheat deficit was supplied by the Danube Basin.

The Continent's self-sufficiency was based also on its high efficiency in converting vast quantities of overseas feed grains and oilseeds into meat, fats and dairy products. This factory-like operation, particularly important in the food economy of Western Europe, not only helped the Continent feed itself, but left small quantities of meat and dairy products for export. Without its efficient animal industry the Continent's dependence on imported food would have been much greater than the figures indicate.

Effect of the War on Food Supply

During the war the Allied blockade threw the Continent more than ever on its own resources. By 1943, although crops were still

generally close to prewar, livestock herds had been so seriously depleted by feed shortage and premature slaughter that meat output in the chief consuming countries was estimated at only 66 per cent of 1933-37 and dairy products 83 per cent. Diversion of grain and potatoes to production of alcohol for munitions further reduced food supplies, and the war interfered with distribution. Farmers as well as city dwellers found their diet restricted in variety. Rationing was conducted primarily for the German war machine; supplies, especially of proteins and protective foods for children and mothers, diminished progressively. Actual hunger, however, was rare.

A study by the Department of Agriculture for the year ended August 1, 1944 estimated that people in liberated Western Europe had available food equal to 2,100 to 2,250 calories currently, while Germany and Central Europe had about 2,500 calories per person. These figures compare with a desirable daily standard of 2,700 calories and the 3,000 calories available daily to consumers in the United States. In the present year the figures will be lower. According to a recently published release of the Office of Foreign Agricultural Relations, the 1944 crops on the Continent were about 5 per cent below the prewar average. But the total food supply should permit, it was estimated, an average consumption equivalent to about 85 per cent of the prewar per capita intake of energy.

The above figures are overall averages for the Continent or individual countries. They would indicate a fairly tolerable situation. The real state of affairs is, however, quite different. In the first place internal distribution has collapsed in most of the Continental countries either because of transportation or because the farmers are unwilling to sell their products for depreciated paper money. In this respect particularly bad situations have developed in France, Belgium and Greece. In the latter country the farmers refuse to sell their products for the newly introduced currency. As a rule, not until more goods are produced will the internal distribution in individual countries improve. For the time being, farmers will continue to eat well, while the city people have to subsist on as little as two-thirds and even one-half of the already subnormal intake of energy.

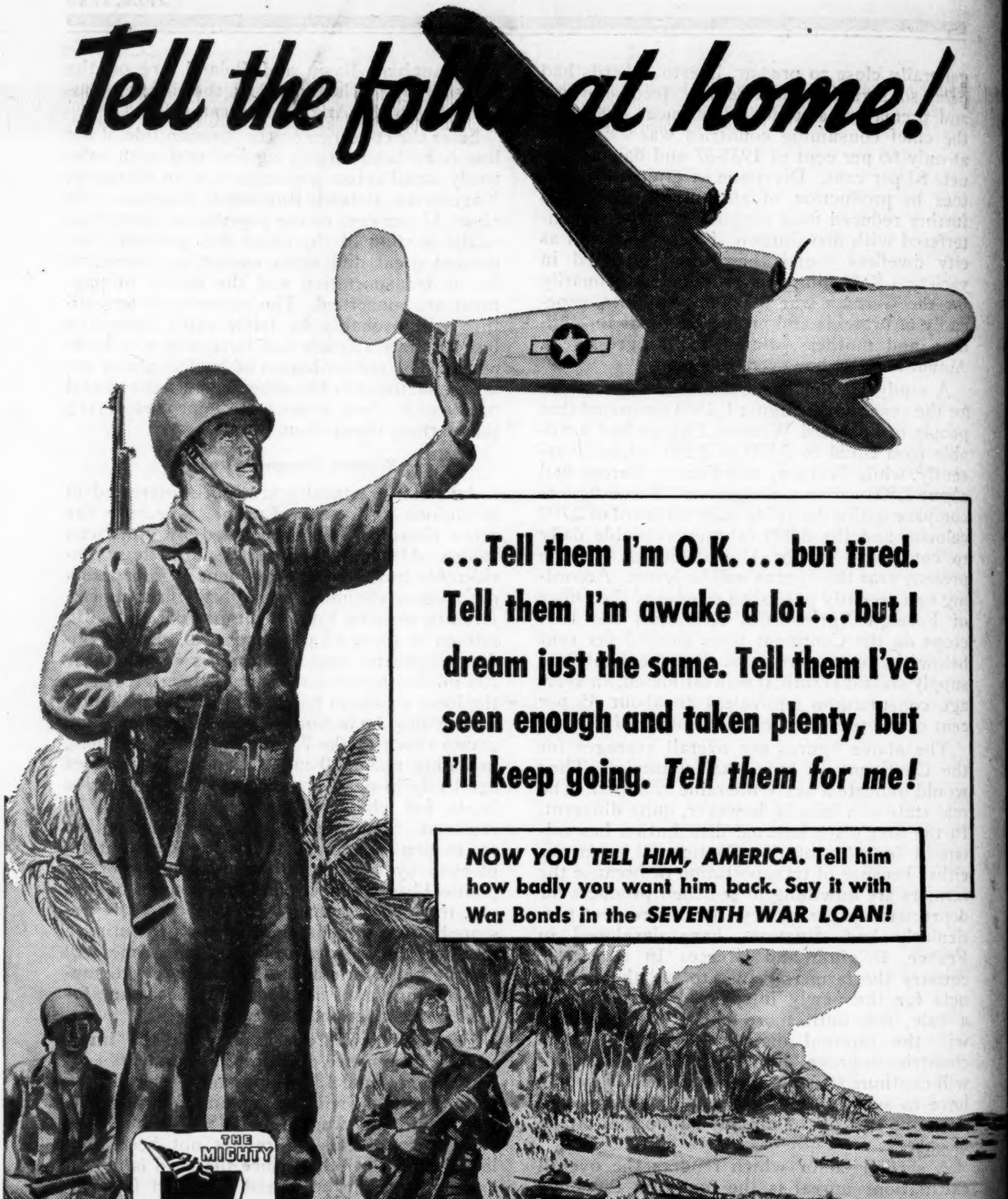
A second factor which renders the overall calculations unreal is the fact that the huge intra-Continental trade in foods has collapsed, partly because of the general disruption of communication and partly because no trade of any kind moves, so far, across the line of demarcation between the Russian and the Anglo-American armies. This means that most of the important agricultural-surplus areas, such as the Danubian Basin and Poland, are on the Russian side, while most of the deficit countries are on the Anglo-American side.

Since the countries on the Russian side of the line have been largely agricultural with relatively small urban populations, — in Hungary, Yugoslavia, Poland, Roumania, Bulgaria only about 15 per cent of the population was urban - the feeding of the cities will probably not present great difficulties except, of course, as far as transportation and the means of payment are concerned. The recovery of agriculture will probably be fairly rapid though a lack of draft animals and fertilizers will hamper it. The redistribution of land is also a delaying factor. On the other hand, agricultural practices in these areas were improved during the German occupation.

Western Europe's Situation

Americans naturally are more interested in conditions in western Europe, especially the areas liberated by or occupied by American troops. Although this area is normally a considerable importer, the problem is fortunately not so overwhelming as might at first appear. Even in western Europe the population of 210 million is about 65 per cent rural, and all evidence indicates that the farmers among these 135 million people can sustain themselves and the local non-farm population in health though variety may be lacking. The real problem then comes down to the 75 million urban dwellers, including about 20 million under 15 years of age badly in need of milk and other protective foods, for whom emergency supplies will be required. Some means must be found either to reopen former channels of distribution, blocked by transportation breakdowns or by political barriers, or to find new sources of supply, if prewar dietary standards are to be restored. Certain consuming areas, presenting a more critical feeding problem at this time, will require quick outside assistance merely to supply the minimum food elements necessary for health in the immediate future.

For western Europe as a whole the Interagency Committee on Foreign Shipments estimates that some 12 million short tons of food from overseas will be required during the year beginning August 1, 1945. Although the breakdown of this figure has not been published, it is clear that, since the need is urgent and both ocean and inland transport facilities limited, emphasis must be on those staples which supply greatest food value per ton, which means cereals, sugar, and fats and oils. While this estimate is probably the best currently available, much depends on the progress of the growing crops in Europe and the prospects for fall planting.



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